

British Columbia Securities Commission  
Alberta Securities Commission  
Saskatchewan Financial Services Commission – Securities Division  
Manitoba Securities Commission  
Ontario Securities Commission  
Autorité des marchés financiers  
New Brunswick Securities Commission  
Nova Scotia Securities Commission  
Newfoundland and Labrador Securities Commission  
Registrar of Securities, Prince Edward Island  
Registrar of Securities, Northwest Territories  
Registrar of Securities, Yukon Territory  
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March 9, 2006

Dear Sirs/Mesdames:

**Proposed Amendments to National Instrument 51-102, *Continuous Disclosure Obligations*, (“NI 51-102”)**

We are pleased provide our comments on the proposed changes to this instrument. We also want to take this opportunity to raise a few other NI 51-102 implementation issues that we have identified, but which are not addressed in the proposed amendments.

We strongly support the proposed elimination of the requirement for a compilation report the pro forma financial statements included in a Business Acquisition Report.

We would welcome any opportunity to discuss our responses with you in greater detail.

Yours very truly



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## **I. Response to Certain Requests for Comment**

### **Delivery of financial statements**

*As we recognize that an issuer may need time to copy the statements after filing them, we have extended the delivery deadline to no later than 10 days after the filing deadline. Do you agree with this change?*

**Response:** Last year we surveyed the year end reporting timelines for a “haphazard” sample of issuers other than venture issuers. All of the issuers sampled prepared and filed annual reports to shareholders, which we presume provided them with an exemption from the requirement to mail financial statements upon request. Of the 37 issuers in the sample, only three of them filed their annual reports more than 10 days after the financial statements filing deadline of 90 days. Based on these results we believe the proposed delivery deadline is reasonable.

## **II. Comments on Other Proposed Changes**

### ***Compilation Report on Pro Forma Financial Statements***

For many years appropriate assurance standards have existed for an auditors' examination of pro forma financial statements, however, there has been virtually no demand for such professional engagements in the North American capital markets. The procedures performed under the existing Canadian professional standards are substantially less than an audit or a review and in our view should not be considered to "expertize" the pro forma financial statements.

***We strongly support the proposed elimination for a compilation report on pro forma financial statements included in a BAR. We hope a conforming change will be reflected when the CSA concludes its project to harmonize Canadian long form prospectus requirements.***

### **III. Comments on Other Implementation Issues**

#### ***1. Incorporation by Reference of a Business Acquisition Report (“BAR”) into the Annual Information Form (“AIF”)***

Paragraph 4.2(a) of Form 51-102F2 requires the issuer to incorporate by reference any Forms 51-102F4 filed by the issuer since its previous AIF. We have been advised by external legal counsel that the filing of the AIF constitutes a release of the BAR (including the audit report on the audited financial statements of the acquired business) as of the date of the AIF. This “second release” of the BAR has significant implications for the auditor under both Canadian professional standards (including the CICA Assurance & Related Services Guideline “The Auditor’s Written Consent to the Use of the Audit Report in a Continuous Disclosure Document”) and, where applicable, Ontario’s secondary market civil liability provisions. The second release also has implications for the directors and officers of the reporting issuer.

A further implication for Canadian SEC issuers arises when they file an annual report with the SEC on Form 40-F. The issuer is required to file under cover of Form 40-F the annual information form required under Canadian law. We understand that the Form 40-F is considered to contain any BAR incorporated by reference into the AIF. This in turn triggers requirements for an SEC consent to the use in the Form 40-F filing of the audit report included in the BAR. In certain circumstances this may also trigger a requirement to reconcile the financial statements included in the BAR to U.S. GAAP, a requirement that would not have applied when the BAR was originally filed with the SEC on Form 6-K.

Since the AIF does not include or incorporate by reference the financial statements and MD&A of the reporting issuer, we do not see any merit to maintaining the requirement in paragraph 4.2(a) of Form 51-102F2, particularly in light of the above consequences, which we believe were not foreseen when the revised AIF was introduced in 2004.

***We recommend the deletion of paragraph 4.2(a) from Form 51-102F2 and a conforming revision to paragraph 6 of subsection 11.1(1) of Form NI 44-101F1. (See also our related recommendations made in connection with comment III.2. below.)***

**2. Section 4.6 “Delivery of Financial Statements” and “Release” of Documents under Section 138.1 of the Ontario Securities Act**

Under section 4.6 of NI 51-102 an issuer is required to send “a copy” of its annual financial statements” to a person or company making the request. Instead of sending copies on a request-by-request basis, subsection 4.6(3) effectively provides the issuer with an option to satisfy its delivery obligations by sending the annual financial statements to all of its securityholders, other than holders of debt instruments. As you know, this is commonly done through the medium of an annual report to shareholders, a copy of which required to be filed on SEDAR under section 11.1 of NI 51-102.

In the early days of the implementation of Ontario’s secondary market civil liability regime, we understand some law firms are taking the view that sending a copy of the audited annual financial statements via an annual report may constitute “release” of a “document” under section 138.1 of the Ontario Securities Act and a re-release of the audited annual financial statements contained in the document. Some issuers have eliminated any potential for multiple financial statement “releases” by accelerating the filing of their annual reports to coincide with the filing of their annual financial statements. However, we believe this is impracticable for many Ontario reporting issuers.

A primary implication of a new release of the annual financial statements for the issuer is a need to establish a defence against potential secondary market civil liability. This can be done by conducting a reasonable investigation to have reasonable grounds to believe that the financial statements included in the annual report do not contain a misrepresentation (i.e., there is no untrue statement of a material fact or an omission to state a material fact). As highlighted in the recent judgment of the Ontario Court of Appeal in *Kerr vs. Danier Leather Inc.*, a “material fact” is a broader concept than a “material change”, so in the context of financial statements this reasonable investigation would generally include considering whether events have occurred subsequent to the filing of the annual financial statements on SEDAR that may require adjustment to, or disclosure in, the annual financial statements included in the annual report. Further, in accordance with the recently released professional standards in the CICA Assurance and Related Services Guideline, *The Auditor’s Written Consent to the Use of the Audit Report in a Continuous Disclosure Document*, the issuer’s auditors would not issue a written consent to the use of their audit report in an annual report unless a material subsequent event is appropriately dealt with in the financial statements.

We do not believe that the delivery of a copy of annual financial statements in compliance with section 4.6 of NI 51-102 was intended to sweep issuers, their directors and officers, and others into a new “release” point for purposes of potential secondary market civil liability. In our view, it would be overly harsh for such liability purposes to treat the delivery of a copy of the audited annual financial statements in compliance with section 4.6 in the same manner as the incorporation by reference of the audited annual financial statements into a short form prospectus.

We acknowledge that a resolution of this matter may require an amendment of section 138.1 of the Ontario Securities Act. However, Ontario's secondary market civil liability regime is rooted in the CSA Draft Legislation published in November 2000 and therefore the CSA's views on this matter are very relevant. If the CSA, in consultation with the OSC, shares our sentiments, it may be helpful to include amendments to NI 51-102 that articulate the CSA's views on the intended interaction of the financial statement delivery requirements under section 4.6 of NI 51-102 with secondary market civil liability provisions.

*We recommend the addition of a new subsection 4.6(7) of NI 51-102 as follows:*

*(7) Any financial statements sent by a reporting issuer to the registered holders and beneficial owners of its securities pursuant to this section shall be deemed to have been filed and made available to the public on the date the financial statements were first filed in accordance with this Part 4, notwithstanding that the financial statements may also be filed or made available to the public at a subsequent date.*

*Many reporting issuers satisfy the delivery requirements under section 4.6 of NI 51-102 by including a copy of the audited annual financial statements in an annual report sent to all securityholders, other than holders of debt instruments. Since the requirement to file an annual report generally arises under subsection 11.1(1) of NI 51-102, it may be necessary to add a new section 4.3 to the Companion Policy 51-102CP as follows:*

**4.3 Delivery of Financial Statements – An annual report required to be filed pursuant to subsection 11.1(1) of the Instrument may include a copy of the audited annual financial statements previously filed under subsection 4.1(1) of the Instrument. Consistent with subsection 4.6(7) of the Instrument, such copy of the audited annual financial statements shall be deemed to have been filed and made available to the public on the date the audited annual financial statements were first filed in accordance with Part 4 of the Instrument.**

### ***3. Integration of Business Acquisition Reports into the Short Form Distribution System***

We raised specific concerns in this area in our response last year to the proposed repeal and reissue of NI 44-101. The concerns relate primarily to circumstances where an issuer has made two or more significant acquisitions during the period covered by the pro forma income statements required to be included in a business acquisition report. The CSA's response indicated these concerns would be considered as part of the future amendments to NI 51-102. We were disappointed to see no apparent response to these concerns and are taking this opportunity to reiterate them.

We acknowledge at the outset that multiple significant acquisition circumstances are not common, but neither are they "rare". In a search of BAR filings within the past year we identified 10 issuers that made multiple significant acquisitions. The database we searched did not contain filings prior to March 2005 so this search did not cover filings from the inception of the BAR requirements in April 2004.

The pro forma income statement of the reporting issuer in subsection 8.4(3) of NI 51-102 is required to give effect to significant acquisitions completed after the ending date of the issuer's most recently completed financial year. This means that no consideration is required to be given to significant acquisitions completed during the issuer's most recently completed financial year.

For example, where the issuer made a significant acquisition mid-way through its most recently completed financial year (the "first acquisition") and makes another significant acquisition in the current year (the "second acquisition"), the annual pro forma income statement in the second BAR is required to include a full year of operating results for the second acquisition (pursuant to the "12 consecutive months" requirement under section 8.7 of 51-102CP), but is not required to include a full year of operating results for the first acquisition. When the annual pro forma income statement was prepared for purposes of the first BAR filing, the guidance in section 8.7 of 51-102CP clearly required 12 continuous months of operating results of the first acquisition to be included.

In these circumstances our primary concerns about the pro forma income statement for the second acquisition are (i) the lack of a requirement to provide 12 consecutive months of operating results for the first acquisition and (ii) the multiplicity of pro forma financial statements incorporated by reference into a subsequent short form prospectus. We will use the above example in the following discussions to better illustrate our concerns.

### *Gaps in the Pro Forma Income Statement Information*

If the objective is to present meaningful pro forma financial statements, we cannot understand why the requirements in subsection 8.4(3) would appear to make it acceptable (if not mandatory) to ignore 6 continuous months of operating results of the first acquisition when compiling the annual pro forma income statements for the second acquisition. The existence of such “gaps” (which will be longer for acquisitions made near the end of the preceding year and shorter for acquisitions made earlier in the preceding year) is not acceptable for pro forma income statements included in a long form prospectus filed under OSC Rule 41-501 [see subparagraph 6.5(1)2(a)] or in a registration statement filed with the SEC. If a complete picture is not presented, financial analysts and other astute parties will be left to use the financial statement disclosure in the first BAR to compile their own “amended” pro forma income statement that plugs the gaps in the annual pro forma income statement included in the second BAR. This requires them to make a guess as to operating results of the first acquisition for the “stub period” between the date of the most recent financial statements of that business included in the first BAR and the date of acquisition. It also requires consideration as to whether events subsequent to the filing of the first BAR require modifications to the original pro forma adjustments and underlying assumptions before they can be reflected in the “amended” pro forma.

### *Multiplicity of Pro Forma Income Statements*

The combination of subsection 4.2(a) of Form 51-102F2 and paragraph 11.1(1)(6) of Form 44-101F1 may result in the incorporation by reference of a BAR into a short form prospectus up to two years after the original filing of the BAR. We consider this to be a reasonable period for determining the historical financial statement disclosure required for a significant business acquisition because in many cases the combined effect of the above requirements will result in the BAR “dropping off the table” at a point in time when the acquired business has been consolidated into the issuer’s audited financial statements for a complete year. (This is consistent with the exception provided for a long form prospectus in subsection 6.6(1)(a) of OSC Rule 41-501.) However, when an issuer has made several significant acquisitions during this period, the incorporation by reference of all of the BARs will result in a multiplicity of pro forma income statements. (A possible scenario involving three significant acquisitions over a two year period is illustrated in the Appendix.) This variety in the number, periods covered and nature (annual and interim) of pro forma income statements concerns us because we feel the prospective investors are being left to fend for themselves when it comes to putting all the pieces together. Factor in the steady stream of retroactive changes in accounting principles that will inevitably occur on the road towards adopting International Financial Reporting Standards in Canada and there is a real prospect for incorporating into prospectuses a confusing array of potentially inconsistent pro forma financial information.

***Our Recommendations***

In order for the POP System to work smoothly, we appreciate the benefits of relying on previously filed documents to the maximum extent. The elimination in new NI 44-101 of the previous requirements to update pro forma financial statements for purposes of a short form prospectus offering is an example of one compromise from the comparable standards for long form prospectus requirements (and SEC registration statement requirements) that has been made for the sake of facilitating POP offerings. However, in multiple acquisitions circumstances, we believe the quality of pro forma financial statements filed under NI 51-102 can be significantly improved without impeding subsequent POP offering by:

- 1 Amending Part 8 of NI 51-102 to ensure that the pro forma income statements required to be included in a BAR fully reflect (i.e., with no “reporting gaps”) all significant acquisitions made during the periods covered by the pro forma income statements. In virtually all cases the financial information needed to avoid any gaps in the information included in the pro forma income statements is readily available to the issuer.
- 2 Amending Item 11 of NI 44-101 to clarify that when more than one BAR is incorporated by reference into the short form prospectus the only set of pro forma financial statements required to be incorporated by reference is the set included in the most recently filed BAR, unless superseded by more recent pro forma financial statements of the issuer included in the short form prospectus that fully reflect all significant acquisitions during or after the periods required to be covered by such pro forma financial statements and, if applicable, the effects of proposed significant acquisitions.
- 3 Amending Item 11 of NI 44-101 to provide an exception to the requirements to incorporate by reference a BAR into the short form prospectus, if the results of the acquired business for a complete financial year have been reflected in the audited consolidated financial statements of the issuer incorporated by reference into the prospectus. (As noted earlier, this is comparable to the exception in subsection 6.6(1) of OSC Rule 41-501; if the CSA so chooses, the exception could exclude acquisitions at the 100% significance level as is done in subsection 6.6(2) of the OSC Rule 41-501.)
- 4 If none of the above recommendations are adopted, we at least would like to see express permission in Part 8 of NI 51-102 to prepare the pro forma income statement on a basis that included all significant acquisitions made during or after the period covered by the statement.

## APPENDIX

	<b>Filing Date (M/D/Y)</b>	<b>Historical Income Statements of Acquired Business</b>	<b>Pro Forma Income Statements of Issuer</b>
<b>BAR 1</b>	4/10/05 for acquisition of Target 1 on 1/31/05	Nine months ended 9/30/04 and two years ended 12/31/03	Year ended 12/31/04
<b>BAR 2</b>	12/30/05 for acquisition of Target 2 on 10/20/05	Nine months ended 9/30/05 and two years ended 12/31/04	Nine months ended 9/30/05 and year ended 12/31/04
<b>BAR 3</b>	6/30/06 for acquisition of Target 3 on 4/20/06	Three months ended 3/31/06 and two years ended 12/31/05	Three months ended 9/30/06 and year ended 12/31/05

A short form prospectus filed on July 15, 2006 incorporates by reference BAR 3 and incorporates by reference the AIF filed on March 31, 2006, which in turn incorporates by reference BAR 1 and BAR 2. The short form prospectus effectively includes three annual pro forma income statements of the issuer – one for the year ended December 31, 2005 and two for the year ended December 31, 2004 – and two interim pro forma income statements.

While this example seems to portray an extreme circumstance, most scenarios involving a significant acquisition in each of the current and immediately preceding year will result in the incorporation by reference of annual pro forma income statements of the issuer for two different financial years and up to two sets of interim pro forma income statements (which are likely to be based on interim financial statements of the issuer for periods other than those, if any, required to be incorporated by reference into the short form prospectus).

If our recommendations under part III.2 of this letter are adopted, then there would be no need to incorporate by reference BAR 1 into the short form prospectus because the audited annual financial statements of the issuer for the year ended December 31, 2005 include Target 1 for the complete financial year. Also, the pro forma financial statements included in BAR 2 would not be incorporated by reference into the short form prospectus because the more recent pro forma income statement for the year ended December 31, 2005 included in BAR 3 would reflect the results of both Target 2 and Target 3 for 12 continuous months.